of competition for local switching and other services in the traffic sensitive basket, there is no need for the Commission to authorize term and volume discounts for these elements to enable the LECs to compete effectively.

Moreover, because the LECs can deploy switching in increments, the costs of switching generally do not vary with volume in the same way as the costs of transport, and therefore (unlike for transport), any economies of scale for switching are likely to be minimal or nonexistent.[60] If the Commission nonetheless allows term and volume plans for local switching (either by a rule change or pursuant to waivers) -- which it should not -- it should ensure that such discounts reflect only the actual cost differential between the discounted and non-discounted offerings.[61]

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60 See, e.g., NYNEX Telephone Companies Petition for Waiver - Transition Plan to Preserve Universal Service in a Competitive Environment, 10 FCC Rcd. 7445, 7469 (¶ 56 and n.103) (1995) ("NYNEX USPP Order") (Commission "emphasize[d]" that, although it granted NYNEX some measure of deaveraging based on the unique circumstances in the New York City LATA, it has not "reach[ed] a conclusive finding" that non-transport costs vary with density of traffic.)

61 In no event should the Commission allow discounts for the tandem switching charge which, under the interim transport rate structure, is already heavily subsidized via the RIC. See Transport Rate Structure and Pricing, 7 FCC Rcd. 7006 (¶¶ 23-25, 29) (1992), recon., 8 FCC Rcd. 5370 (1993), further recon., 8 FCC Rcd. 6233 (1993), further recon., 10 FCC Rcd. 3030 (1994), appeal pending, sub nom. Competitive Telecommunications Association v. FCC, No. 95-1168 (and consolidated Case No. 95-1170) (D.C. Cir.)

C. The Proposals For Individual Case Basis Tariffs Should Be Adopted To Codify Existing Policy.

AT&T supports the Commission's proposals on individual case basis ("ICB") offerings (i.e., "the practice of developing a price for a particular service or facility in response to each customer request for the service or facility"[62]), which appear to specifically incorporate existing policy, as recently restated by the Common Carrier Bureau.[63] In the SFNPRM, the Commission proposes "requiring a LEC seeking to offer a common carrier service, except for special construction, at ICB rates to show in the supporting documentation that the service is so unlike any existing service that the LEC would have no reasonable basis to develop generally available rates."[64] Section 61.38 support requirements would apply to ICB tariffs, and they would continue to be excluded from price cap regulation. After an ICB tariff is offered to more than two customers or for more

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[62] SFNPRM, ¶ 62, citing Local Exchange Carriers' Individual Case Basis DS3 Service Offerings, 4 FCC Rcd. 8634, 8641, (¶ 63) (1989). Such pricing is usually reserved for services that the carrier "has no experience in providing" or for special construction. Id. ICB services are excluded from price cap regulation because they are contract-type services that are not generally available. SFNPRM, ¶ 63, citing LEC Price Cap Order, 5 FCC Rcd. at 6810 (¶ 193).

[63] See "Common Carrier Bureau Restates Commission Policy on Individual Case Basis Tariff Offerings," Public Notice, DA 95-2053, September 27, 1995 (citations omitted).

[64] SFNPRM, ¶ 65.

than six months, it must be treated as a new service, subject to the new service requirements.[65]

The SFNPRM proposal properly recognizes that instances of ICB pricing, particularly in noncompetitive markets, should be strictly limited. It affords LECs the flexibility to respond to unique customer needs that, at least initially, cannot be based on averaged rates, but recognizes the anticompetitive potential of ICB pricing. To preclude abuses, the proposed test should be strictly enforced, and in no instance should a LEC be permitted to employ ICB pricing for itself or an affiliated entity. Moreover, an offering should not be deemed "unlike an existing service" if it is available through the LEC's end user tariffs[66] or is an inherent part of the LEC network, whether or not it was previously offered to customers.[67]

D. The Part 69 Waiver Process Should Not Be Revised.

The Commission's Part 69 rules prescribe the current switched access elements and underlying rate

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[65] Id.

[66] United States v. Western Electric Co., Civil Action No. 82-0192, Memorandum Opinion (D.D.C. Nov. 26, 1986), aff'd, No. 87-5110 (D.C. Cir. May 10, 1988) (finding U S WEST violated the nondiscrimination provisions of the Modification of Final Judgment by pricing special access to GSA at a rate lower than that available to IXCs).

[67] For example, DS3 trunks were used by the LECs within their own networks prior to being offered to customers under ICB arrangements.

structures. The Commission proposes to change the waiver procedures a LEC must follow to establish a new switched service rate element under Part 69.[68] Specifically, the Commission suggests that a waiver would be granted if the proposed offering "would serve the public interest."[69] Thereafter, copycat rate structures for other LECs would be permitted upon submission of a certification letter stating that the LEC intends to provide the same service with the same elements.[70] Subsequent LECs' waiver requests would be deemed granted within 10 days, unless the Bureau concludes that a copycat offering raises issues not considered in the original waiver. In that case, the Bureau would deny the certification, and the LEC would have to file its own waiver request.

These proposals should not be adopted. In the LEC Price Cap Order, the Commission expressly required the LECs to continue to adhere to the Part 69 rules for the switched access rate elements, because the rate structures embodied

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[68] SFNPRM, ¶ 67.

[69] Id., ¶ 71. The SFNPRM (¶ 72) suggests that the first LEC filing for a waiver could describe the service and possible alternative rate elements, from which the Bureau could choose. Part 69 rate element waivers and a request for Track 2 treatment of the new service could be combined in a single expedited petition.

[70] Id. The certification letter would be required to include a service description and rate elements to allow analysis.

in those rules are designed to eliminate unreasonable discrimination between service users. As the Commission correctly found, in the face of the LECs' significant market power in the provision of interstate access, rules that discourage unreasonable discrimination and its potentially adverse impact on competition should be given precedence over the benefits that might come from LECs' ability to depart from the Part 69 access rate structure.[71] This continues to be the case. Indeed, the Commission only recently concluded that the "record in this proceeding does not support a finding that competition for LEC services is sufficiently widespread to constrain the pricing practices of LECs for new services. Accordingly, the Commission will continue to review new services tariff filings for possible discrimination."[72]

The proposed changes to the Part 69 waiver process would not further the Commission's objective (and obligation) to limit unreasonable discrimination. First, the proposed waiver standard is too lenient, because it runs afoul of the Court of Appeals' admonition that the Commission may not "tolerate evisceration of a rule by

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71 LEC Price Cap Order, 5 FCC Rcd. at 6826 (¶ 325).

72 First Report, ¶ 416.

waivers."[73] Currently a party seeking a waiver must show "good cause therefor," which the courts have interpreted to require a showing that "special circumstances warrant a deviation from the general rule and such deviation will serve the public interest."[74] The Common Carrier Bureau has explained that, before it can grant a Part 69 waiver request, it must find that an applicant has "shown such special circumstances as individualized hardship or inequity that warrant deviation from the Commission's . . . rules and [that] such deviation better serves the public interest."[75]

This test appropriately recognizes that the Part 69 rules themselves further an important objective: nondiscriminatory rate structures. Eliminating the required showing of individual hardship/inequity will almost render the Part 69 rules obsolete, as they apply to the introduction of new service elements. The current waiver test allows LECs to obtain a Part 69 waiver only in limited circumstances. The Commission's proposal would free the LECs from almost any restraints to deviate from the Part 69 rules.

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[73] WAIT Radio v. FCC, 418 F.2d 1153, 1159 (D.C. Cir. 1969), cert. denied, 409 U.S. 1027 (1972).

[74] Northeast Cellular Telephone Co. v. FCC, 897 F.2d 1164 (D.C. Cir. 1990); WAIT Radio v. FCC, supra.

[75] Petition for Waiver of Transport Rate Structure and Pricing Requirements, 9 FCC Rcd. 796, 800 (1994).

Just as important, the proposed waiver procedures do not make sense. According to the Commission, "the first LEC proposing the new switched access service [would be permitted] to provide less specificity in the description of its proposed rate structure than we have required previously."[76] Based on the LEC's service description and various alternative rate element proposals, the Bureau could choose acceptable rate elements. However, in the absence of specific information on the proposal, neither the Bureau nor interested parties could properly evaluate the potentially discriminatory impacts of the proposed rate structure.

Moreover, once an initial waiver request is approved, other LECs would then be permitted to copycat the rate structure. This "copycat" procedure erroneously assumes that the circumstances which justify granting a Part 69 waiver request for one LEC would be equally applicable to all LECs.[77] Under the Commission's proposal,

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[76] SNFPRM, ¶ 72.

[77] In recent Part 69 waiver requests, the Commission has generally relied heavily on the specific competitive circumstances of the individual LEC to evaluate whether special circumstances warrant such a waiver. For example, in the NYNEX USPP Order (¶¶ 38, 39, 46), the Commission accepted the NYNEX premise that "competitive developments" in the NYNEX market constitute "special circumstances." Under the Commission's proposal, a NYNEX-like petition would no longer be evaluated to test if "competitive circumstances" have created any "special circumstances" to justify a waiver. Moreover, all other LECs would automatically get the same waiver without any

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not only would the first LEC be allowed to establish new Part 69 rate elements with minimal scrutiny, but once it obtains permission to establish certain new rate elements, all other LECs would almost automatically get permission to follow suit.

Thus, for all practical purposes, LECs would be able to obtain broadscale de facto rule changes with minimal Commission scrutiny, and interested parties would only have the opportunity to evaluate the Part 69 waiver request of the first LEC petitioner. Knowing that approval of the first waiver request will mean almost automatic approval of copycat requests, interested parties would be forced to treat the first waiver request as a rulemaking, and to evaluate the waiver request as if it were applicable to all other LECs. In short, the revised waiver procedures would replace the current rulemaking process, without the usual notice and comment timeframes, and without the careful scrutiny and deliberation, typically associated with rulemaking proceedings.

In view of the LECs' significant market power, each LEC must be required to show that its own special circumstances warrant a deviation from Part 69 rules in establishing new switched access rate elements, and that

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consideration of the conditions in their individual markets.

such deviation is in the public interest. Simplified Part 69 waiver processes should not be a substitute for rulemaking. Moreover, instead of deflecting its resources by acting on piecemeal and potentially anticompetitive waiver requests under a relaxed standard, the Commission should implement fundamental (and much-needed) access reform by promptly conducting rulemakings that address the anticompetitive and uneconomic impacts of the subsidies that currently inhere in the access and separations rules.[78]

E. Lower Service Band Index Limits Should Be Eliminated, Provided Safeguards Against Cross-Subsidization and Predatory Pricing Are Imposed.

The Commission proposes eliminating the lower service band indices ("SBIs") for each of the service categories and subcategories within the traffic sensitive and trunking baskets.[79] According to the Commission,

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[78] The Commission has recognized that this system of subsidies was created in a monopoly environment and itself acts as a barrier to local exchange competition. NYNEX USPP Order, ¶¶ 26, 29, 44; SFNPRM, ¶¶ 24-26.

[79] SFNPRM, ¶ 83. The current SBI limits for service bands in the traffic sensitive and trunking baskets are set at five percent above and ten percent below the aggregate price of each service band and sub-band at the beginning of each rate period. The lower SBI limits for the zone density sub-bands are set at fifteen percent. These upper and lower SBI limits then become a "no suspend" zone within which the LECs may move their prices, as adjusted for changes in the baskets' price cap indices ("PCIs"), with a presumption of lawfulness. By contrast, price changes that lower the aggregate price in a service band or sub-band below the lower SBI limit must be filed on 45 days' notice and must be accompanied by supporting materials establishing that the rates cover the service

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eliminating the lower SBIs "would increase LEC pricing flexibility and allow price cap LECs to move prices closer to cost."[80] At the same time, the Commission notes that the tariff intervention and Section 208 complaint processes would remain available to address predatory pricing, although the upper SBI limit and the price cap "would remain as disincentives to predatory pricing."[81]

AT&T supports the Commission's proposal to eliminate lower SBI limits to help move access prices to their economic costs. However, because eliminating lower SBI limits could result in cross-subsidization and predatory pricing, sufficient safeguards must be put in place to protect the LECs' customers and potential competitors against these practices, and to ensure that this additional pricing flexibility will, in fact, help achieve cost-based pricing.

The Commission has repeatedly noted that the current upper and lower SBI limits serve two key purposes.

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band's average variable cost. See 47 C.F.R. § 61.49(d) (1994). See also Section 61.47 of the Commission's Rules, as amended by the First Report. Eliminating the lower band limit would allow LECs to file rate decreases (below the preexisting limit) with a presumption of lawfulness, on short notice and without cost support.

80 SFNPRM, ¶ 83.

81 Id.

First, they restrict LECs' ability to engage in cross-subsidization among different service categories by decreasing the prices in one band and increasing the prices in some other band.[82] Second, the lower band limits serve as disincentives for LECs to engage in predatory pricing.[83] Without appropriate safeguards, elimination of lower SBI limits will substantially enhance LECs' ability to cross-subsidize among service categories.

The current price cap system allows the LECs to compensate for price decreases in one service band by increasing the prices of any other service band in the same price cap basket. By eliminating the lower SBI limits, LECs' flexibility to compensate for the rate decreases by

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[82] SFNPRM, ¶ 80. (". . . the services category bands constrained the LECs' ability to offset rate reductions in some service categories with rate increases in other categories.") See also LEC Price Cap Order, 5 FCC Rcd. at 6810-11 (¶ 198).

[83] SFNPRM, ¶ 105. ("The lower service band limits were designed to prevent LECs from lowering their prices below cost in order to thwart competition and then raising them after competitors have been driven from the market." SFNPRM, ¶ 83). Thus, the current +5% and -10% service band limits, relative to changes in basket PCIs, assure that during any rate year, LECs will not be able to increase the prices of any service band by more than 5%, to compensate for price decreases in any other service band. Similarly, the lower service band limits of -10% for the service bands and sub-bands, and -15% for the zone density sub-bands, serve as a check on LECs' ability to decrease the prices for the sole purpose of discouraging competitive entry in their markets. See LEC Price Cap Order, 5 FCC Rcd. at 6814 (¶ 226); see also First Report, ¶¶ 26, 29, 384, 409-11; SFNPRM, ¶ 77.

raising the rates in other bands will substantially increase.[84] Thus, LECs will be able to impose additional rate increases on their captive customers, while providing rate relief to their more competitive services. More importantly, there would be no aggregate decrease in LEC access prices, because the LECs would be able to fully recover the price reductions of one service band from price increases in other service bands.

The sole legitimate purpose for granting LECs additional downward pricing flexibility is to permit them to move their service prices to their economic costs more quickly. Therefore, the Commission should, as a condition of eliminating lower SBI limits, require the LECs not to compensate for their below-band price reductions with price increases in the other service bands.[85] This can be

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[84] Appendix B demonstrates that removal of lower SBI limits will substantially increase a LEC's ability to cross-subsidize among service bands. In the example displayed in Appendix B, Example 1, under the current rules, a LEC with two service bands in a price cap basket, where Band A is priced at $1000, and Band B is priced at $4000, will be able to move only $271 from Band A to Band B over a three-year period. Once the lower SBI limits are removed, Appendix B, Example 2, shows that the same LEC would be able to move $631 from Band A to Band B over the same period. This is a 233 percent increase in the LEC's ability to cross-subsidize among the service bands. Appendix B, Example 3, further demonstrates that placing a one percent upper limit on price increases, after the prices are decreased below the lower SBI limits, will still provide the LEC with the same 233 percent increase in its ability to cross-subsidize among service bands.

[85] An extreme measure would be to place the service bands in which LECs implement below-band pricing in a separate

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accomplished by requiring the LECs to exclude any price reductions beyond the existing lower limits from the basket Actual Price Index ("API") calculation. This will enable the LECs to compensate for price reductions only up to the preexisting lower SBI limits of a band, but will ensure they cannot compensate for price decreases that are below the current SBI lower limits.[86]

In addition, the Commission should adopt its proposal to reduce the upper SBI limit from five percent to one percent for any service category or subcategory in which a LEC makes price reductions below the former SBI limit.[87] In combination with the above safeguard to deter cross-subsidization among service bands, this limit will further the Commission's policy goals of moving LEC prices toward

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price cap basket, in addition to subjecting these bands to a one percent upper SBI limit.

86 The Commission could implement this condition by requiring the LECs to report two sets of prices for bands when they implement pricing below the former band limits. One set of prices would be those that would have resulted if, at the time below-band prices were first implemented, the LEC had priced the band at its existing lower SBI limit. This set of prices would change only with subsequent changes in the basket PCI and would be used for any subsequent API calculations. LECs should also report their actual prices. As long as the SBI that is calculated for actual prices is below the SBI calculated for the other set of prices, the actual rates should be excluded from the API calculation.

87 SNFPRM, ¶ 105.

cost and achieving permanent access price reductions. It will also deter predatory pricing behavior because, by restricting the LEC's ability to raise a price after it has been lowered, it discourages temporary price reductions.

The two safeguards identified above are needed because, contrary to the Commission's suggestion, the current upper service band limit and the basket price cap do not provide adequate protections.[88] The basket PCI does not provide an effective check on LECs' ability to price a particular service below cost for a period of time, and then later raise it back to its previous level. The PCI only establishes a ceiling on aggregate prices of the LECs' services within a given basket. If a LEC sets its aggregate basket prices so they are below the basket PCI, it can raise them back to the PCI any time in the future on short notice. Pricing below the PCI creates permanent pricing "headroom" for the LEC, until it increases the aggregate basket prices back to its PCI.

The five percent upper SBI limit provides, at most, a limited check on a LEC's ability to increase the price of a service, after it has been decreased. In each LEC's annual filing, the upper and lower SBI limits are re-established in relation to the existing aggregate price levels within each band. Because (absent changes to the

[88] SFNPRM, ¶ 83.

basket PCI) the upper SBI limits remain in effect for one year, and are then re-established in relation to the year-end aggregate band prices, a LEC can maneuver its prices to retain the same upward pricing flexibility that it had for the band before the price decrease.[89]

In short, the PCI and upper SBI limits provide only limited restrictions on LECs' ability to increase prices (and those restrictions are further subject to manipulation). Therefore, AT&T strongly urges the Commission to impose additional safeguards to limit the LECs' ability to increase prices after the lower SBI limits are eliminated. This is particularly important because the elimination of lower SBI limits will shift the burden of

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[89] See 47 C.F.R. § 61.47(e) (1994). For example, if the existing aggregate price of a service band at the time of a LEC's annual tariff filing is \$100, the upper SBI limit will be established at \$105. If the LEC decides to lower the aggregate band price down to its lower SBI limit of \$90 at the beginning of the rate year, it can raise it back to its original level any time during the rate year. Additionally, if just prior to its next annual filing, the LEC increases the price back to \$100, in the annual filing its new upper limit will again be established at \$105, and the LEC will retain the same pricing flexibility that it had before. Only if the LEC continues to price the band at less than \$100 into the next rate year would the new upper SBI limit be set at less than \$105. Indeed, GTE and NYNEX both pursued the tactic of increasing rates just prior to their 1995 annual filings, to establish higher upper SBI limits. See GTE Telephone Operating Companies Transmittal No. 962, and GTE System Telephone Companies Transmittal No. 145, both filed May 8, 1995; NYNEX Transmittal No. 374, filed April 14, 1995.

proof from the LECs to the intervenor/complainant in tariff filing and Section 208 complaint proceedings.[90]

F. The Price Cap Baskets Should Not Be Revised At This Time.

The Commission asks whether the four existing price cap baskets (common line, traffic sensitive, trunking, and interexchange) should be revised based on the development of competition for certain services and how the basket structure should be changed as competition continues to emerge.[91] Except for the creation of certain new services categories in the traffic sensitive basket needed to protect consumers, there is no need to modify the basket structures at this time.[92] Future rulemakings may be required to address whether basket revisions are appropriate for all or some LEC markets after a demonstration of changing marketplace circumstances.[93]

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[90] SFNPRM, ¶ 83.

[91] SFNPRM, ¶ 90. The day after the SFNPRM was released, the Commission created a new video dialtone basket. See n.97, infra. The SFNPRM (¶ 91) also inquires whether, now or in the future, the expanded interconnection tariffs should be brought into price caps. AT&T believes that these tariffs should be included in price caps as a separate service category in the trunking baskets, so that the price cap rules would apply to future rate changes for these elements.

[92] See Section III.H, infra, as to the need for separate service categories in the traffic sensitive basket for the LECs' operator and LIDB services.

[93] The Commission also raises a number of issues concerning "sharing." SFNPRM, ¶ 77. The only circumstance which would warrant a relaxation of sharing requirements -- to

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The Commission created the LEC price cap baskets and the service categories and bands within the baskets to "replicate the effect of competition" in the exchange market.[94] Thus, the price cap plan was intended to create economic incentives for the LECs to improve their productivity and to offer new services -- incentives that approximate those that would exist in a competitive local exchange market. At the same time, the structure was designed to protect consumers because "[s]ubdividing LEC services into baskets substantially curbs a carrier's pricing flexibility, as well as ability to engage in unlawful cost shifting between the broad groupings of services."[95] Given the lack of competition in the access and local exchange markets, the price cap basket structure should not be revised at this time to afford additional pricing flexibility to the LECs.

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permit the LECs to retain the fruits of their productivity -- would be the establishment of a productivity offset (X-Factor) which properly reflects the LEC's productivity. AT&T plans to address this issue further in response to the Fourth Further Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 95-406, released September 27, 1995 ("X-Factor Notice").

[94] Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, 9 FCC Rcd. 1687 (¶ 38) (1994) ("NPRM").

[95] LEC Price Cap Order, 5 FCC Rcd. at 6811 (¶ 200); First Report, ¶¶ 29, 379.

Before adopting the LEC price cap plan, the Commission considered a wide variety of basket structures, and after careful deliberation, adopted the four service baskets with their related categories and subcategories.[96] The Commission has made modifications to those baskets and categories only after extensive analysis and deliberations regarding specific markets.[97] In constructing the baskets, the Commission intended carriers to have "little incentive to shift costs between baskets, because changes in prices within one basket do not affect prices in the others. Within the basket, however, the carrier has the incentive to change prices, in order to increase efficiency and maximize its profits."[98]

The Commission's decisions thus represent a balance of competing considerations: incentives for the

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[96] See, e.g., LEC Price Cap Order, 5 FCC Rcd. at 6810-11.

[97] See Expanded Interconnection Order With Local Telephone Company Facilities, 9 FCC Rcd. 5154, 5194-5200 (¶¶ 149-67) (1994) ("Virtual Collocation Order") (reviewing earlier orders that required category expansion in the special access (now trunking) basket to accommodate zone density pricing for special access and switched transport); Transport Rate Structure and Pricing, 9 FCC Rcd. 615, 622-27 (1994) ("Second Transport Order") (realigning the traffic sensitive and special access baskets to create a new trunking basket); Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd. 11098 (1995) ("Second Report and Order") (establishing a separate price cap basket for video dialtone services).

[98] NPRM, ¶ 38.

LECs, and protections for consumers. Nothing has occurred since the Commission's most recent revisions to these baskets in the Second Report and Order less than three months ago that suggests this balance should be disturbed at this time.

AT&T agrees that some alterations in the price cap basket structure may be warranted if competition develops.[99] But the fact remains that there is no meaningful facilities-based competition in access and local exchange markets today, nor is effective competition likely to develop any time soon.[100] Thus, at this time, market forces cannot replace the consumer protections provided by existing price cap controls. In the absence of market forces to restrain LEC pricing behavior, any changes to the current price cap structure to provide the LECs additional pricing flexibility would be harmful to customers. Thus, the basic structure of LEC service baskets should be retained to preclude excessive rates and cross-subsidies.

Moreover, because of the complexity of introducing, realigning or consolidating baskets and the impact of such activities on both the LECs' ratepayers and their potential competitors, basket revisions cannot be planned to take place automatically on achievement of

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[99] See Appendix A, pp. 21-22.

[100] See Part I, supra.

particular milestones.[101] Rather, to allow for full consideration of specific, concrete basket revision proposals, the Commission should initiate periodic rulemakings to evaluate whether such revisions are appropriate for all or particular LEC markets.

G. Service Categories Should Not Be Consolidated.

The Commission also asks whether service categories (which limit the LECs' ability to offset rate decreases in one service band with rate increases in other service bands in the same price cap basket) could be consolidated to allow for greater pricing flexibility.[102] For example, the Commission notes that USTA has advocated consolidating the DS1 and DS3 subcategories in the trunking basket.[103]

As the Commission correctly points out, if the lower service band index limits were eliminated (as proposed), then "consolidation of service categories would not provide any additional downward pricing flexibility, but instead would provide [solely] additional upward pricing

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[101] See SFNPRM, ¶ 92. For example, revising the number of baskets or the geographic coverage of any given basket could require reexamining the level at which the productivity offset or "X-Factor" in the price cap formula is set. See LEC Price Cap Order, 5 FCC Rcd. at 6812 (¶¶ 209-10).

[102] SFNPRM, ¶ 93.

[103] SFNPRM, ¶ 94.

flexibility by creating 'headroom' for services that are in the same service category with services for which the LECs have lowered their rates."[104] Given the lack of effective competition in the access and local exchange markets, allowing the LECs any additional pricing flexibility to increase their rates is detrimental to all of the Commission's major policy objectives.[105] Thus, LEC service categories should not be consolidated to grant LECs increased upward pricing flexibility.

It may, however, be necessary to reevaluate the composition of service bands as the relative competitive status of LEC services changes. Within the traffic sensitive and trunking baskets, the Commission grouped similar services in service bands for the purpose of limiting "the LECs' ability to shift costs between services in a potentially anticompetitive manner."[106] As the Commission explained:

> "We created separate service categories in the price cap plan to group together services with high cross-elasticities of demand. This limits the LECs' ability

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[104] SFNPRM, ¶ 94.

[105] See SFNPRM, ¶ 1.

[106] First Report, ¶ 379. In particular, the Commission, incorporated "the various flat-rated transport service offerings into the corresponding special access service categories . . . [to constrain] . . . the LECs' ability to offset lower DS3 . . . rates with higher DS1 . . . rates." See Second Transport Order, 9 FCC Rcd. at 625-26 (¶ 22).

> to offset rate decreases for more competitive services with rate increases for less competitive services."[107]

Because the LECs have unlimited pricing flexibility to cross-subsidize among the services within a band, the service composition of bands should be evaluated in light of changing market conditions. Otherwise, if some of the services in a band are no longer competitive with one another, the LECs will be able to offset rate decreases for more competitive services with rate increases for less competitive services. The service bands were created to avoid exactly this kind of consumer harm.[108]

In the First Report (¶ 414), the Commission expressly recognized that it may be necessary to reexamine the composition of baskets and bands, as competition develops in local markets, to guard against anticompetitive

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[107] SFNPRM, ¶ 93.

[108] Bell Atlantic's recent tariff filing, Transmittal No. 827, filed October 11, 1995, which modified its Directory Assistance and Information surcharge rates, is an example of this phenomena. Bell Atlantic's Directory Assistance services now face some competition, whereas White Pages information does not. In Transmittal 827, Bell Atlantic restructured its Directory Assistance service by establishing term pricing plans and lowering rates for this service. At the same time, Bell Atlantic increased its information surcharge rate, so that there is no aggregate change in Bell Atlantic's revenue stream from its information service band. Id., p. 1-4. Bell Atlantic was able to shift the cost recovery from a more competitive service to a non-competitive service only because both of these services, which have developed different competitive characteristics, remain in the same service band.

cross-subsidization. Thus, the Commission should evaluate proposals to realign services within the service bands or to consolidate service bands, based on a showing of major changes in the competitive characteristics of the services that would be affected and whether the proposed modification would protect ratepayer interests.

H. New Service Bands For Operator Services, LIDB and Operator Call Completion Services Should Be Created In The Traffic Sensitive Basket.

The Commission asks whether "a new service category [should] be created in the traffic sensitive basket for . . . operator transfer service [0- transfer] and line status verification," as proposed in the Operator Services Notice.[109] Alternatively, the Commission asks whether operator services should be combined with others in the traffic sensitive basket, such as, for example, Billing Name and Address ("BNA").[110] The SFNPRM also inquires as to the

[109] SFNPRM, ¶ 96, citing Treatment of Operator Services Under Price Cap Regulation, 8 FCC Rcd. 3655 (1993) ("Operator Services Notice"). "Operator transfer" occurs when a LEC operator receives a 0- interLATA call and the LEC transfers the call automatically to the IXC selected by the caller. "Line status verification" occurs when the operator checks the line for an IXC operator to determine whether it is busy or out-of-service and interrupts if it is busy and an emergency exists. Id.

[110] SFNPRM, ¶¶ 97-98.

proper price cap treatment for both operator-related and directory assistance-related call completion services.[111]

Currently, there is no specific rule mandating the classification of LEC operator services. Thus, price cap LECs have accorded those services widely disparate treatment.[112] The Commission tentatively concluded in the Operator Services NPRM that the current treatment provides the LECs an unwarranted ability to raise rates for these operator services relative to their other traffic sensitive or interexchange rates.[113] This is also the case with the

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[111] SFNPRM, ¶¶ 99-102. "Operator-related call completion" service is the automated handling of calling card, third party, collect calls or live operator assistance. Id., ¶ 99. "Directory assistance-related call completion" occurs when the carrier completes the call for the end user immediately after providing the directory information. Id., ¶ 100.

[112] Some carriers have incorporated those rate elements in their interexchange baskets (i.e., Bell Atlantic, BellSouth, NYNEX (line status verification service), Pacific Bell and Southwestern Bell). Others have included these services in the information category of the traffic sensitive basket (i.e., GTE, SNET (line status verification service) and United). And still others have assigned them to the local transport category in the trunking basket (i.e., Ameritech (operator transfer service), NYNEX (operator transfer service) and SNET (operator transfer service)).

[113] See Operator Services Notice, 8 FCC Rcd. 3655 (¶ 4). The LECs' ability to adjust their access rates in this manner is illustrated by NYNEX's 1992 annual access tariff filing. There, NYNEX proposed increases of up to 47 percent in its rates for line status verification access service which that carrier had included in the interexchange basket, and reductions of up to 50 percent for the "corridor" services NYNEX offers directly to end users in competition with IXCs.

LECs' Line Information Data Base ("LIDB") services, which IXCs depend upon for validation of the LECs' joint use calling cards.[114] To address both these problems, the Commission should establish separate categories in the traffic sensitive basket for operator services and for LIDB, and apply a five percent upper banding limitation to those rates to "ensure that operator services [and LIDB access] customers as a whole will not experience large price increases" for these offerings.[115]

In addition, operator-related call completion services should be included in the operator services band proposed for the traffic sensitive basket, because they depend on use of the LECs' operator services. Similarly, directory assistance-related call completion services should be placed in the information service band, because this

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[114] Most LECs have included LIDB services in the trunking basket's high capacity/DDS category, and United and Centel have included LIDB in the traffic sensitive basket's local switching category. Bell Atlantic, BellSouth and U S WEST have increased their per-query LIDB rates by 30, 18 and 14 percent, respectively, over the level established by the Commission only two years ago. See Local Exchange Carrier Line Information Database, 8 FCC Rcd. 7130 (1993); Bell Atlantic Transmittal No. 644, filed April 1, 1994; BellSouth Transmittal No. 247, filed December 15, 1994; and U S WEST Transmittal No. 596, filed February 17, 1995. If the LECs' LIDB services remain in the trunking basket or in the traffic sensitive basket's local switching category, LECs will continue to have similar opportunities to increase their LIDB rates.

[115] Operator Services Notice, 8 FCC Rcd. 3655 (¶ 4).